VZCZCXRO0273
PP RUEHCD RUEHGD RUEHHO RUEHMC RUEHNG RUEHNL RUEHRD RUEHRS RUEHTM
DE RUEHME #0184/01 0241547
ZNY CCCCC ZZH
P 241547Z JAN 08
FM AMEMBASSY MEXICO
TO RUEHC/SECSTATE WASHDC PRIORITY 0218
INFO RUEHXC/ALL US CONSULATES IN MEXICO COLLECTIVE
RUEHZP/AMEMBASSY PANAMA 2230
RUEHSN/AMEMBASSY SAN SALVADOR 2495
RHMFISS/DEPT OF ENERGY WASHINGTON DC
RHEHNSC/NSC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 05 MEXICO 000184

SIPDIS

SIPDIS

STATE FOR A/S SHANNON
STATE FOR WHA/MEX, WHA/EPSC, EB/IFD/OMA
TREASURY FOR IA (ALICE FAIBISHENKO, ANNA JEWEL)
TREASURY FOR OCC/IBF (SUSAN QUILL)
TREASURY FOR IBSMO (WILBUR MONROE, BILL FOSTER)
EXIM FOR MICHELE WILKINS
CFTC FOR OIA (WARREN GORLICK)
NSC FOR RICHARD MILES, DAN FISK
SEC FOR OIA (SHAUNA STEELE)
STATE PASS TO USTR (EISSENSTAT/MELLE/SHIGETOMI)
STATE PASS TO FEDERAL RESERVE (ANDREA RAFFO/ANN MISBACK)
DOE FOR A/S HARBERT, WARD, AND LOCKWOOD

E.O. 12958: DECL: 01/21/2031
TAGS: ECON EFIN PGOV AMGT PINR
SUBJECT: AMBASSADOR'S MEETING WITH FINANCE MINISTER CARSTENS

REF: A. MEXICO 146
¶B. STATE 6151)
¶C. 07 MEXICO 6186

Classified By: Ambassador Antonio O. Garza, reasons 1.5. (b) and (d).

Summary and Introduction

¶1. (C) In a luncheon with Ambassador Garza on January 18, Finance Minister Agustin Carstens speculated that personnel changes in the Calderon Administration are over for right now. He defended agricultural policies that have helped fuel calls for the ouster of Agricultural Minister Cardenas. Carstens discussed the importance of U.S.-Mexico Customs and Treasury cooperation, especially against money-laundering. He noted that cooperation in using information technology to automate Customs procedures was especially important now that Customs officials seriously combating smuggling were under threat from traffickers. Carstens said that the U.S. economic slowdown was already hurting Mexico's manufacturing sector, but predicted that President Bush's stimulus package, the depreciation of the U.S. dollar and Mexican peso, and the strength of the U.S. corporate sector would mitigate the effects of the slowdown. On economic reform, Carstens thought the government had until late November to get its proposals through Congress before electoral politics blocked progress. He discussed plans for justice, energy and telecom reform. Carstens believed that interim measures to increase recovery of oil in place would allow Mexico to make up for declining production in the Cantarell oil field, but said Mexico would face a crisis in eight to ten years if sufficient energy reform were not enacted. Regarding Carstens' previous request that the USG extend Medicare benefits to Mexico, Ambassador Garza noted the difficulties and suggested that Mexico work with the Embassy to look at other ways to attract retirees, such as measures undertaken in Panama and Costa Rica to streamline residency visa procedures. Regarding the USG request that Mexico resolve its dispute with the U.S. Fireman's Fund Insurance Corporation in

order to avoid a state-to-state NAFTA dispute, Carstens said that because Mexico has won this case at every stage, it lacked the legal authority to pay compensation to FFIC. The Ambassador also used the meeting to request Carstens' help in reducing the backlog in issuing diplomatic license plates to the U.S. Embassy. End summary.

Cabinet Changes Done for Now

¶2. (C) Regarding recent changes in President Calderon's cabinet and other key posts (See septel), Carstens said he thought personnel changes were over "for right now." He admitted that Agricultural Minister Cardenas was vulnerable (Ref. A), but agreed that firing him at the current moment would appear to be giving in to political pressure. Carstens defended Mexico's agricultural policies, noting that the sector had received a record amount of support in the FY 2008 budget, a 15% increase to roughly USD 18.5 billion. He said the reason for recent protests was that special interests, i.e. the leaders of the farmers' groups, had been cut out by the recent reforms to ensure agricultural support funds go to farmers, rather than intermediaries.

-- ----------
Mexican Military Protects Customs Against Narco Threats
-- ----------

¶3. (C) Ambassador Garza asked about the recent deployment of Mexican military to assist Mexican Customs in the Mexican State of Tamaulipas. Carstens explained that the military was providing perimeter security to protect Customs officials

from narcotics traffickers. Now that Mexican Customs was seriously working to stop drug and other smuggling, he said, traffickers were threatening Customs officials. Carstens noted that one reason for the urgent need for the U.S. and Mexico to make progress in information technology efforts to automate Customs clearances was to make Customs officers less vulnerable to identification and death threats.

U.S.-Mexico Cooperation Going Well

¶4. (C) Carstens praised Mexican-U.S. cooperation, especially with U.S. Customs and Treasury's Office of Technical Assistance. Anti-money laundering cooperation in particular, he said, was going very well. When the Ambassador stressed the importance of Mexico adopting a law to allow civil forfeiture of assets, Carstens replied that he thought such a reform was part of the justice reform package currently before the Mexican Congress, but he was not certain because it is an issue managed by the Office of the Attorney General (PGR), not the Ministry of Finance.

-- -------
Pinning Hopes on a Successful U.S. Stimulus Package?
-- -------

¶5. (C) When asked how well Mexico would weather a U.S. economic slowdown, Carstens said the effect on Mexico would be less severe because of the fiscal stimulus package President Bush had just announced. Under Secretary of Finance for Finance and Public Credit Alejandro Werner was late for the luncheon explaining that he had been watching President Bush's announcement. Werner had been encouraged by the announcement, but then discouraged by the news immediately thereafter of more U.S. firms posting record losses. Werner asked for information about the stimulus package. (Comment: The Embassy has since passed on information from Treasury's Office of International Affairs and information in Ref B. End Comment.)

¶6. (C) Carstens acknowledged that Mexico's auto and durable goods sectors had been hurt by the U.S. slowdown, since tQse were the first areas to lose sales when consumer credit tightens. He predicted that the decline of the U.S. dollar, however, would add a half to one percentage point to U.S. growth, and would boost Mexican exports. Because the value of the Mexican peso has closely followed that of the U.S. dollar, he said, the Mexican peso has depreciated not only against the Euro, but against some Latin American currencies. This depreciation, he explained, was keeping Mexico's productive sectors going.

¶7. (C) Another reason Carstens believed the U.S. economic slowdown would be less damaging to Mexico was that the strength of the U.S. corporate sector would mitigate the U.S. downturn. Unlike previous recessions, he said, U.S. corporations have strong balance sheets and huge amounts of cash that will start to be invested once things stabilize. He also cited huge liquidity worldwide and depressed asset prices that would bring increased investment to the U.S.

¶8. (C) In response to a question on criticism of some in the United States about sovereign wealth funds, Carstens noted that it was a natural phenomenon for the U.S. to attract investment flows from abroad. In any case, he said, U.S. financial institutions had no choice due to the lack of sufficient capital within the United States to restore the financial health of these institutions.

Window for Reform in Mexico

¶9. (C) When asked how upcoming Mexican legislative elections in 2009 may hinder efforts to get Congressional passage of reforms, Carstens speculated that the government has until the federal budget is completed in late November to make progress before electoral wrangling blocks further progress. He noted the importance of achieving justice reform. He said the fact that all three political parties recognized the importance of justice reform made him optimistic that they would work together to pass something in February 2008.

¶10. (C) On energy reform, Carstens said the Calderon Administration is trying to be low key. He thought that Congress would take up energy reform after both the 70th anniversary of the nationalization of the energy sector and the PRD party elections in March. If the PRD elected "a more useful President," he believed that energy reform could move forward. Regarding the type of reform being considered, Carstens said that "all topics were on the table," including the critical issues of how to open the energy sector to capital flows. He said it was a question of how far and how aggressively Mexico would pursue those topics.

¶11. (C) During a discussion on U.S. investors, EconMinCouns noted that U.S. investors cite high electricity and telecom rates as major disincentives to investing in Mexico. Carstens noted that telecom was a problem of a private monopoly, and he hoped there would be telecom reform to lower rates because there was "no justification for the current situation." Although electricity is provided by a government monopoly, Werner explained, the problem is not monopoly power but inefficiency in electrical production. The main government monopoly, CFE, continued to loose money despite charging high rates. Carstens said that part of the revenue from the recent tax reform would be used to increase subsidies for electricity tariffs for industry in order to reduce their cost of operations.

¶12. (C) Ambassador Garza noted that a key reason that President Calderon's reform agenda was moving forward was Carstens' success in working with Congress. "Yes," Carstens joked, "they are all my buddies. We have all become good

friends."

Holding Off an Energy Production Crisis

¶13. (C) Carstens predicted that Mexico could offset declining production at its main Cantarell field over the next four years by replacing Cantarell production through increased efficiency in producing oil. Currently, he said, the state oil monopoly Pemex extracts a small percentage of the oil in its fields. Increasing recovery by even 10 percent would help alleviate the decline at Cantarell. He said the plan included extracting oil from abandoned fields in Tamaulipas using new technology on old fields. He also said the use of smaller fields at Campeche would help offset Cantarell's decline. Because of such measures, Carstens predicted that Mexico had 8 to 10 years before it would face a crisis if there were insufficient reform of its energy sector. (Comment: Most knowledgeable industry insiders with whom we have spoken are less sanguine about opportunities for enhanced recovery and improved reservoir management techniques to significantly offset Mexican production declines. End Comment.)

Helping Develop the Retiree Sector in Mexico

¶14. (C) During the November 2007 visit of State Assistant Secretary Dan Sullivan and Treasury Assistant Secretary Clay

SIPDIS
Lowery, Carstens had laid out Mexican plans to create jobs by attracting U.S. retirees to Mexico (Ref C). As part of this

effort, Carstens requested that the U.S. expand Medicare coverage to Americans living in Mexico. Ambassador Garza explained that expansion to Mexico was a complex issue entailing political and practical difficulties. He noted that the Departments of Treasury and Health and Human Services were looking into the technicalities, but suggested that given the difficulties, the GOM look at other ways to facilitate the retirement of U.S. citizens in Mexico. He suggested the U.S. Embassy could work with the Mexican government on exploring measures, such as simplifying residency visa requirements and facilitating small-scale investments by retirees that Costa Rica and Panama have used to attract U.S. retirees. Carstens and Werner were very interested, and said they would look into the possibilities and get back to the Ambassador. Carstens noted that many Americans in resort areas were operating small businesses like art galleries, and it would be in everyone's interest to help those businesses into the formal economy not only to attract retirees, but to build Mexico's tax base. (Comment: That very same day, a Ministry of Finance official had visited the U.S. Embassy Consular Section requesting assistance in distributing a Finance Ministry survey to American citizens on what works and what does not work for Americans re-locating to Mexico. The Consular Section agreed to help distribute the survey, and offered insights based on Embassy experience helping U.S. citizens who have re-located to Mexico. End Comment.)

Deal on Fireman's Fund Not Possible

¶15. (C) Ambassador Garza noted that the U.S. Government would prefer for Mexico to settle the USD 50 million dispute with Fireman Fund Insurance Corporation (FFIC) rather than having a government-to-government NAFTA dispute. Carstens replied that Mexico had already won the case, in fact Mexico had won at every stage. EconMinCouns explained that the NAFTA investor-state panel had ruled for Mexico on technical

grounds because FFIC did not have standing under NAFTA's investor rules, but had made clear its view that FFIC had suffered discriminatory treatment. Encouraged by the panel's finding of discrimination, FFIC is now pressing the USG to lodge a state-to-sate NAFTA complaint against Mexico. Carstens replied that, although $50 million was not a large amount, Mexico had won the case and therefore the government had no authority to compensate FFIC. On the prospects of a government-to-government dispute, Carstens wryly noted that both sides had probably spent more than USD 50 million in legal fees.

Delays in Issuing License Plates

¶16. (SBU) The Ambassador thanked Carstens for helping clear up much of the back-log of diplomatic plates issued to Embassy personnel and official vehicles. He noted that many of the people who had been waiting over a year for diplomatic plates had now received them, but delays had resumed and there was again a backlog. The Ambassador requested Carstens' help in clearing this new backlog, noting that the problem may be with the Foreign Ministry, which works with the Finance Ministry to issue the plates.

Comment

¶17. (C) Carstens was clearly pleased with the quality of cooperation between his Ministry, his Customs Service and U.S. Customs and Treasury. As increased success in combating smuggling brings increased threat from the traffickers,

U.S.-Mexico cooperation will only grow more critical. It was interesting that Carstens' answer to why Mexico would weather a U.S. slowdown were based on hoped-for successful U.S. efforts, rather than the Mexican efforts Carstens has talked about at considerable length publicly (See Septel). Carstens often makes the case to Mexican audiences that, unlike during previous U.S. recessions, Mexico's internal economy is now strong enough to mitigate the effects of a U.S. slowdown. He explains that increased oil revenue and revenue from the tax reform will allow the government to use fiscal policy to boost domestic demand, such as through President Calderon's National Infrastructure Development Plan. He notes that Mexico's internal economy is now more dynamic, and its exports are somewhat more diversified despite the dependence on the U.S. market for 85 percent of manufactured goods exports. His hopes, however, also are clearly pinned on the success of U.S. efforts to reverse the perceived trend toward recession. While continued success on the reform agenda should raise Mexico's growth rate over the longer term, ever since NAFTA Mexico's economic cycles have been even more closely tied to the up and downs of the U.S. economy. Mexico's dependence on the U.S. market means that in the short-term, they are likely to rise and fall with us.

Visit Mexico City's Classified Web Site at
http://www.state.sgov.gov/p/wha/mexicocity and the North American Partnership Blog at http://www.intelink.gov/communities/state/nap /
GARZA